



# Comprehensive Annual Financial Report

*For the fiscal year ended June 30, 2004*



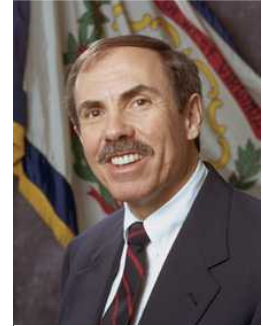
**State of West Virginia  
Public Employees Insurance Agency**

*(an enterprise fund of the primary government of West Virginia)*

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**Public Employees Insurance Agency**  
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*Bob Wise, Governor*

**Comprehensive Annual  
Financial Report**

*For the fiscal year ended June 30, 2004*

Bob Wise, Governor  
State of West Virginia

John Poffenbarger, Acting Cabinet Secretary  
West Virginia Department of Administration

B. Keith Huffman, Co-Acting Director and General Counsel  
West Virginia Public Employees Insurance Agency

*Prepared by:*  
Jason A. Haught, CPA  
Co-Acting Director and Chief Financial Officer  
West Virginia Public Employees Insurance Agency

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**State of West Virginia  
Public Employees Insurance Agency**

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*For the fiscal year ended June 30, 2004*

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# Introductory Section

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## **Rapid Growth and Innovation Seen in PEIA's Pathways to Wellness Program**

Beginning as a pilot program at just four sites in 1992, the Pathways to Wellness Program is now in over 500 worksites across the state, providing preventive screening services to over 10,000 active employees a year. The program offers participants free screens for heart disease, diabetes, hypertension, prostate cancer, and osteoporosis. Follow up services are provided to members with risk factors, ensuring physician involvement in addressing immediate issues; and member encouragement for participation in appropriate behavior change programs including those addressing nutrition, tobacco cessation and physical activity.

One of our most popular offerings is the Stepping Stones Pedometer (step counter) Program. By using this simple device as a motivational tool, we found that out of 8,000 participants, 81.3% increased their levels of physical activity with concurrent improvements in their risk factors. PEIA also remains committed to promoting good nutrition through our support of the national 5 a day program (fruits and vegetables) and our "portions" campaign. (Please visit our website: [www.wvportions.com](http://www.wvportions.com) to see our billboards and listen to our radio/tv ads.) Our bold campaign has been nationally recognized by the National Governor's Association Chronic Disease Academy and the U.S. Centers for Disease Control and Prevention.



**WV Toll-Free: 1-888-680-PEIA • Phone: 1-304-558-7850 • Fax: 1-304-558-2516 • Internet: [www.wvpeia.com](http://www.wvpeia.com)**

December 28, 2004

The Honorable Bob Wise, Governor  
State of West Virginia

Mr. John Poffenbarger, Acting Cabinet Secretary  
West Virginia Department of Administration

Mr. Keith Huffman, Co-Acting Director  
West Virginia Public Employees Insurance Agency

Gentlemen:

It is a privilege to submit to you the Comprehensive Annual Financial Report of the West Virginia Public Employees Insurance Agency (PEIA) for the fiscal year ended June 30, 2004. This report was prepared by the office of the PEIA Co-Acting Director and Chief Financial Officer. Responsibility for both the accuracy of the data presented and the completeness and fairness of the presentation, including all disclosures, rests with the management of PEIA. To the best of our knowledge, the data is accurate in all material respects and is reported in a manner designed to present fairly the financial position and results of operations of the various funds, account groups and component units of the State. All disclosures necessary to enable the reader to gain an understanding of PEIA's financial activities have been included.

The Comprehensive Annual Financial Report is presented in three sections: introductory, financial and statistical. This introductory section contains this transmittal letter, a list of the principal officials of PEIA and PEIA's organizational chart. The financial section includes the financial statements and auditor's opinion, as well as certain required supplementary information as described in more detail in the table of contents. The statistical section includes selected financial, economic and demographic data for PEIA.

PEIA was established under the Public Employees Insurance Act of 1971, to provide hospital, surgical, group major medical, prescription drug, group life, and accidental death and dismemberment insurance coverage to eligible employees; and to establish and promulgate rules for the administration of these plans. Benefits are made available to all active and retired employees of the State of West Virginia and various related State agencies and local governments. Participants may elect health insurance coverage through a fully self-insured preferred provider benefit plan (PPB) or through external managed care organizations (MCO). Additionally, all participants may elect to purchase additional life insurance under the optional life insurance policy.

As noted in previous years, PEIA is required to adjust the State employer and State employee

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## 2004 Comprehensive Annual Financial Report

aggregate cost sharing percentages over a five year period. These adjustments must begin in fiscal year 2003 with the required ratio established by fiscal year 2007. The adjustments will result in a change in the plan's contribution level of State employers and State employees from the original 90% from State employers and 10% from the State employees, to 80% from employers and 20% from employees. The following chart depicts an updated percentage of contribution levels due to various factors such as enrollment fluctuations and plan migration.

| <b>Employer/Employee Contribution Increases<br/>(in thousands)</b> |         |          |          |         |          |          |
|--|---------|----------|----------|---------|----------|----------|
|  | FY 2002 | FY 2003  | FY 2004  | FY 2005 | FY 2006  | FY 2007  |
| State Employer   | N/A     | \$39,500 | \$39,200 | \$8,000 | \$40,000 | \$25,000 |
| State Employee   | N/A     | 19,700   | 15,600   | 0       | 5,700    | 21,800   |
| Total  | N/A     | \$59,200 | \$54,800 | \$8,000 | \$45,700 | \$46,800 |
| State Employer Share   | 86%     | 83%      | 82%      | 82%     | 83%      | 80%      |
| State Employee Share   | 14%     | 17%      | 18%      | 18%     | 17%      | 20%      |

Unfortunately, due to an anticipated large contribution by the State in FY 2006, a significantly smaller anticipated increase for employees and no employee increase in 2005, the progress towards the required ratio has regressed. This necessitates a large increase for employees in fiscal year 2007. The mandated transition has been a difficult one and may be challenged by employee advocates in the next legislative session.

The PEIA Finance Board is required to develop five-year financial plans each fall that begin with the next fiscal year commencing in July. The financial plan must incorporate a mandated reserve fund equal to 10% of total forecast plan expenses for that fiscal year. The fiscal year 2004 year-end PEIA reserve (net assets) did meet the mandated 10% reserve requirement. The year-end reserve was 27% of total plan costs. The current financial plan forecasts PEIA meeting the 10% reserve requirement for fiscal years 2004 through 2008.

PEIA is reported as an enterprise fund in the State of West Virginia's Comprehensive Annual Financial Report. After applying the criteria set forth in generally accepted accounting principles, PEIA management has determined there are no organizations that should be considered component units of PEIA.

## OUTLOOK FOR THE FUTURE

PEIA has now completed two fiscal years with favorable results. This has allowed PEIA to develop a considerable reserve to offset any unforeseen losses due to expensive technological advancements in healthcare or increased utilization. Both of which are inevitable, as advancements in healthcare are always in demand and the medical community in the United States will thankfully continue to supply.

A recent advancement in healthcare is that of specialty drugs. Specialty drugs are genetically engineered compounds designed for the treatment of specific disease states. They are utilized in the treatment diseases such as cancer, hemophilia and Parkinson's Disease. Specialty drugs are

## 2004 Comprehensive Annual Financial Report

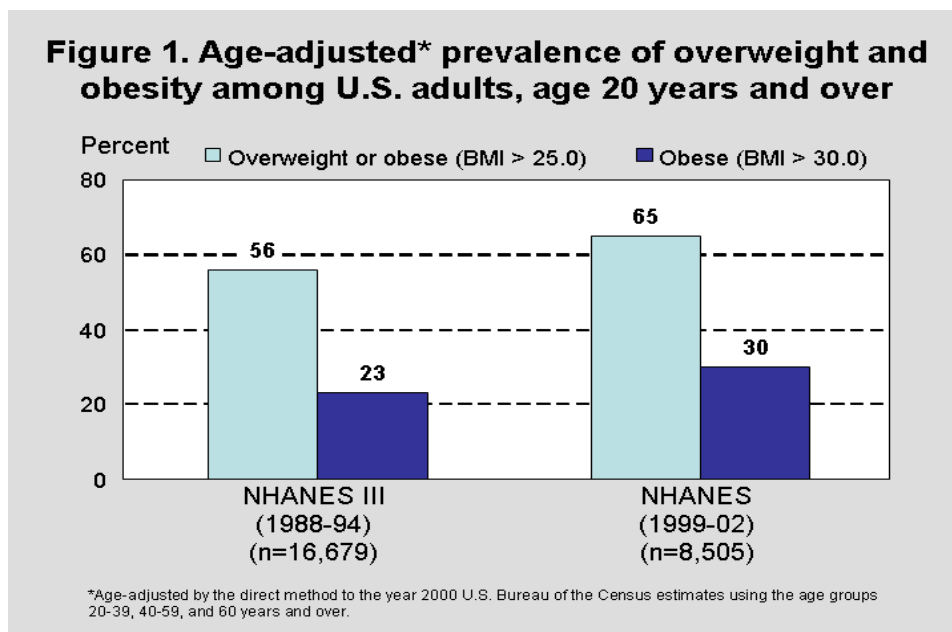
distinguished by their biotech nature and specialized use, high cost, how they are administered and the manufacturing and distribution process.<sup>1</sup>

Specialty drugs are commonly administered by medical professionals, or self administered by patient if trained to do so, and have a limited shelf life. Due to administration by medical professionals in most cases, specialty drugs have mostly been billed and paid as a medical expense in the past. But due to increased availability and the advent of specialty pharmacy management companies, these drugs are now being billed as a pharmacy claim, or carved out altogether as a separate benefit class.

The cost and increasing availability of specialty drugs are one issue PEIA must be prepared to deal with. Currently, there are nearly 200 specialty drugs available on the market today with an estimated 600 products in the research pipeline soon to be available.<sup>2</sup> As an example, one of PEIA's top 50 drugs in fiscal year 2004 was Enbrel. Enbrel is a specialty drug for the treatment of rheumatoid arthritis. Ingredient cost per prescription for this drug was \$1,193.

In addition to specialty drugs, which if applied and administered properly can be a life improving, cost saving treatment in the long run; various disease states and conditions continue to be of great concern to PEIA. One such condition PEIA is concerned with is obesity. The national rate of obesity is increasing at a significant rate as the following information from the Centers for Disease Control and Prevention indicates.

“Results from the 1999-2002 National Health and Nutrition Examination Survey (NHANES), using measured heights and weights, indicate that an estimated 65 percent of U.S. adults are either overweight or obese. As shown in Figure 1 below, this represents a prevalence that is 16 percent higher than the age-adjusted overweight estimates obtained from NHANES III (1988-94).”



<sup>1</sup> SEGAL Company, August 2004 Newsletter.

<sup>2</sup> Ibid.

## 2004 Comprehensive Annual Financial Report

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Obesity leads to increased risk of type II diabetes, hypertension, high blood cholesterol, coronary disease and high blood pressure. PEIA has a significant rate of the above conditions. As Tables 8 and 9 denote, Lipitor, a cholesterol controlling medication, is the number one prescribed drug by ingredient cost and diseases of circulatory system is the number one diagnostic category.

These are but two factors that contribute to PEIA's current claims expense trend assumptions for fiscal year 2005 that are outlined below:

| Eligibility  | Medical Trend | Drug Trend |
|--------------|---------------|------------|
| Non-Medicare | 9.0%          | 18.0%      |
| Medicare     | 8.5%          | 18.0%      |

The above trends projections are consistent with findings in industry surveys. The 2005 Segal Health Plan Cost Trend Survey indicates calendar year 2005 health plan cost increases are expected to be lower than in the past. PEIA's drug trend projection was recently lowered by PEIA's independent actuary for both Medicare and Non-Medicare by three percentage points resulting in the above 18%. However, even with this lower trend, 18% is still an exceptional number when applied to PEIA's \$129 million drug claim expense.

PEIA's independent actuary also reduced Non Medicare medical trend by 1% for FY 2005. The actuarial trend assumption adjustments are a result of the lower than expected claims expenses the past two fiscal years.

Main drivers to these positive results are due to initiatives PEIA has implemented during these periods. Specifically, PEIA's change in pharmacy benefits manager (PBM), PBM contracting philosophy and increased discounts for inpatient hospital services. Looking beyond fiscal year 2005, PEIA forecast trends to increase by a half a percent per year for both medical and drug trend.

Although PEIA has had positive results over the past two fiscal years, there are still specific expense items that are running at trends higher than PEIA would like to see.

Outpatient hospital medical and surgical services have had a per-capita average trend of 12.5% over the past two fiscal years. Due to medical advancements, more severe cases are now treated in an outpatient setting. Thus, higher utilization of more costly services are now included in this expense item. This condition is exacerbated by the fact that PEIA reimburses many outpatient charges on a discount off of charge basis. This reimbursement methodology leaves PEIA with little virtually no cost control for this claims expense category.

A significant future event that PEIA must incorporate in future finance and benefit plans is the recently passed Medicare Part D (Part D) drug benefit. This new benefit by Medicare should result in substantial savings to PEIA. However, it is difficult to ascertain the exact savings at this point. There are options a plan may choose to incorporate the Part D benefit. These options have significant variance on impact to PEIA as the current legislation is understood.

For fiscal year 2007, these options range in impact to PEIA from \$24 million in savings, if Medicare is secondary to PEIA, to \$86 million if PEIA elects transfer of Medicare retirees to Medicare completely. Further, the Medicare secondary option is the largest enigma at this point



due to incomplete information regarding the methodology and formulas regarding how PEIA will be reimbursed for its Medicare retiree's drug costs.

In conclusion, as with every year, there are new challenges facing PEIA. Healthcare is an ever-evolving industry with significant demand and PEIA must be prepared to provide it in an efficient, affordable manner. Although trends in the healthcare regularly out pace other commodity inflation rates with no reprieve in sight, PEIA has positioned itself to withstand them and provide an effective medical and prescription drug insurance coverage for our members in the near future.

### MAJOR INITIATIVES

PEIA is currently underway with multiple initiatives. The first and most significant is the implementation of the Outpatient Prospective Payment System (OPPS) for Ambulatory Procedure Classes (APC's), or outpatient hospital services. The OPPS for APC's will be implemented January 1, 2005. This is a significant step for PEIA. The PEIA OPPS will be virtually identical to Medicare's OPPS.

The implementation of OPPS is intended to be revenue neutral for the hospitals with respect to current reimbursement for these services. However, with this reimbursement methodology, PEIA will not be susceptible to the possibility of exorbitant charging for outpatient services. Currently, hospitals can maximize revenue through adjustments to charges on certain procedures, regardless of the actual costs. Thus, PEIA could pay substantially more for a service than it actually costs the hospital to provide.

OPPS sets the reimbursement amount for a particular service regardless of what is billed by the hospital. The hospital will be reimbursed what the OPPS reimbursement code allows, not a percent of what the charge. This will create cost controls for PEIA by removing the susceptibility to charges that the current system allows and assures all hospitals are paid equally for the same services.

At this point, there are no immediate savings anticipated due to the revenue neutral implementation. But the past two years have seen an average increase of 12.5% in this claims expense category. This trend will now only be affected by Medicare rate adjustments to OPPS based on cost reports. This was a major undertaking by PEIA and its third party administrator, Acordia National. When a reimbursement methodology for an entire class of services is revised, significant programming and process revisions are necessary.

PEIA has also implemented a very innovative program to counter the issue raised earlier regarding the increasing rates of obesity. This program will provide benefits for policyholders that have qualified to participate in the obesity management program. Depending on their body mass index (BMI), and existence of co-morbidities or other illnesses, they will be placed into two different benefit plans that vary in intensity. The participants will receive services ranging from counseling from weight management coaches to licensed dieticians and exercise physiologists.

There is a risk of not making an impact with this benefit. This is a progressive benefit for a difficult condition. However, it was a decision that management believed necessary due to the

## 2004 Comprehensive Annual Financial Report

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high levels of obesity seen in West Virginia. This is a condition that, in some cases, can be treated and can significantly improve the health of a member.

As a result of the increase in available specialty drugs, utilization and the associated costs, PEIA has begun consideration of various plan changes to accommodate specialty drug benefits. Currently, specialty drugs are either included in medical claims and billed by the provider or obtained by the policyholder via a pharmacy if possible and are billed and paid as a pharmacy benefit. In the latter instance, the policyholder would pay \$5, \$15 or \$30 for a prescription that can cost as much as \$1,200.

PEIA simply will not be able to afford this cost share once the projected level of specialty drugs in the “pipeline” become available. Many options are available. Plans have completely carved this particular class out and increased the co-pay, or have paid the benefit as a percentage cost sharing medical benefit, i.e. eighty/twenty ratio. At this point, PEIA is pondering carving out all new specialty drugs and placing a higher co-pay and out of pocket maximum for this benefit than the regular prescription benefit. Specialty drugs regularly administered by medical professionals will remain a medical benefit and currently available specialties will remain in the pharmacy benefit with a phased transition into the new specialty drug benefit category.

To assist PEIA in this decision, it has requested proposals from three different specialty drug providers. With these proposals, PEIA will determine the best package by assessing the cost, distribution logistics, utilization management, drug counseling and training services that will be provided to our policyholders and providers.

Although these initiatives do not address all the challenges facing PEIA, it is small steps like the above that can make a larger impact in the future. It is managements hope that the above initiatives will continue to provide PEIA with nationally comparable trends and the resulting ability to provide appropriate coverage to our policyholders at an affordable cost.

## FINANCIAL HIGHLIGHTS

The financial statements of PEIA have been prepared on an accrual basis in conformity with generally accepted accounting principles for governmental entities as prescribed or permitted by the Governmental Accounting Standards Board (GASB).

### Internal control and budgetary control

PEIA’s management is responsible for establishing and maintaining internal controls designed to ensure that the assets of PEIA are protected from loss, theft or misuse and to provide that financial statements are prepared in conformity with generally accepted accounting principles (GAAP). Internal controls are designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that the cost to administer the control should not exceed the benefits derived from the control. An annual budget is prepared each fiscal year to be used by management for planning and evaluating performance.

### Financial performance and forecasts

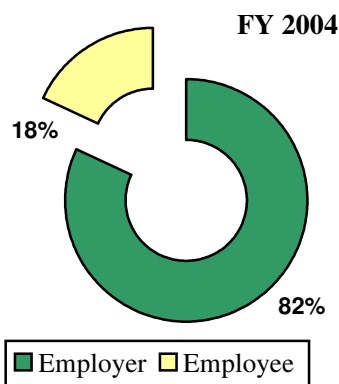
The PEIA had a change in net assets for fiscal year 2004 of \$63,573,753 resulting in an end of year net asset amount of \$139,754,214. PEIA had significant increases in premium revenues and claims expense. For further details regarding PEIA's financial condition, please see the Management's Discussion and Analysis section in the financial section beginning on page 16 that incorporates a narrative introduction, overview and analysis of the financial statements.

The current plan design and funding mechanism under the baseline projection model forecasts the following increases (decreases) in net assets over the next five years:

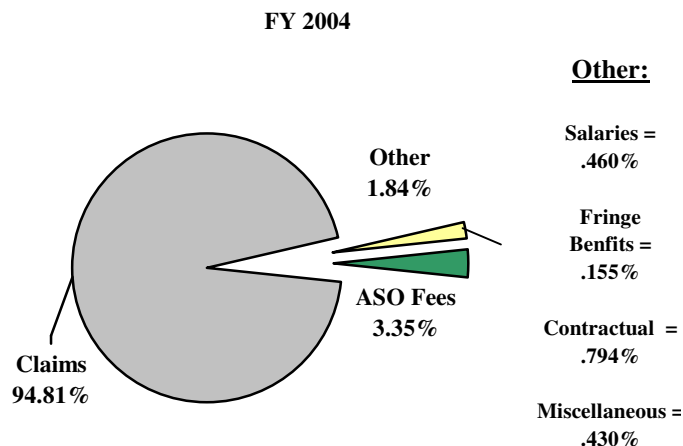
| FY 2005      | FY 2006     | FY 2007     | FY 2008        | FY 2009        |
|--------------|-------------|-------------|----------------|----------------|
| \$15,622,732 | \$7,670,887 | (\$100,834) | (\$16,984,779) | (\$28,373,470) |

### General government functions

The primary function of PEIA is paying insurance claims for its beneficiaries which are financed through employer and employee contributions as illustrated below:



Administrative expenses include payments to third party administrators and the wages and benefits of PEIA employees.



### **Proprietary operations**

As previously noted, PEIA is reported as an enterprise fund in the State of West Virginia's Comprehensive Annual Financial Report. It is PEIA's intent to cover operating costs through user charges in the form of insurance premiums to employers and employees who participate in PEIA.

### **Cash management**

Cash and cash equivalents are managed by the West Virginia Investment Management Board. In addition, PEIA has funds on deposit with a local financial institution for payment of claims processed by PEIA's third party administrators. Cash in these accounts are the assets of PEIA until such time as claims are paid.

### **Risk management**

PEIA was established to provide the following employee benefits to the State of West Virginia employees and their dependents: hospital, surgical, group major medical, basic group life, accidental death, and prescription drug insurance coverage.

### **OTHER**

#### **Independent audit**

PEIA is required by the Financial Accounting and Reporting Section of the Department of Administration to have an annual independent audit. The firm of Ernst & Young, LLP was selected to perform the audit for fiscal year ended June 30, 2004. Their report is included in the financial section of this report.

#### **Awards**

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to West Virginia Public Employees Insurance Agency for its comprehensive annual financial report for the fiscal year ended June 30, 2003. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

### Acknowledgments

Special thanks are extended to Governor Bob Wise, for his support in stressing the importance of fiscal responsibility and financial reporting. Acknowledgement is also given to the Legislature and its leadership, whose continued support will promote the future success and stability of the program. Finally, this report would not have been possible without the dedication and effort of PEIA's Director, Keith Huffman. Respectfully, we submit the Comprehensive Annual Financial Report for the West Virginia Public Employees Insurance Agency for the year ended June 30, 2004.

Sincerely,

A handwritten signature in black ink, appearing to read "J.A. Haught". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Jason A. Haught, CPA  
Co-Acting Director and Chief Financial Officer



### Principal Officials

Bob Wise, Governor  
*State of West Virginia*

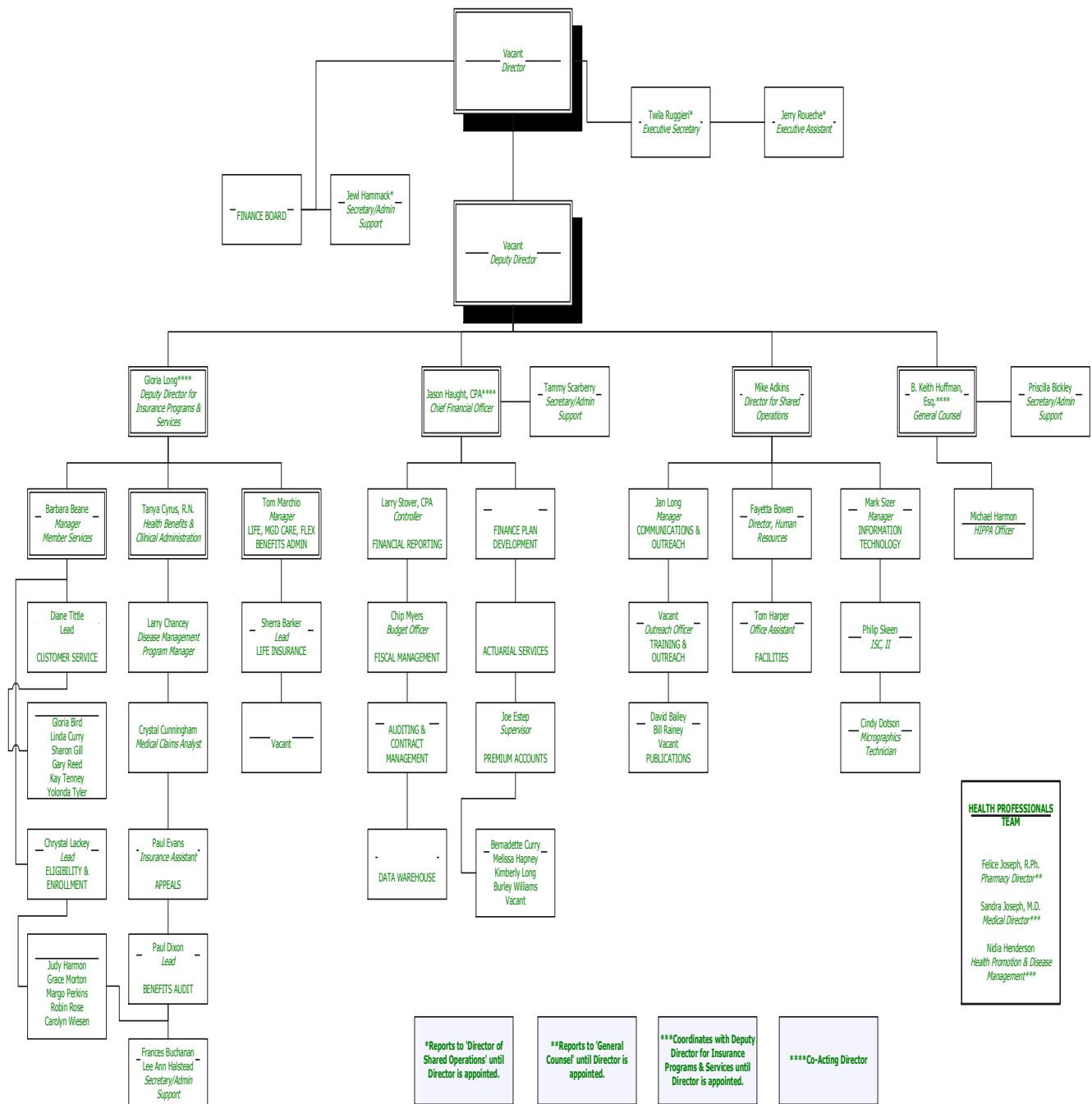
John Poffenbarger, Acting Cabinet Secretary  
*West Virginia Department of Administration*

### Finance Board

John Poffenbarger, Chairman  
Perry Bryant, Member  
John D. Culler, Member  
Elaine Harris, Member  
John Ruddick, Member  
James Schneider, Member  
Denise White, CPA, Member

### Executive Staff

Keith Huffman, Co-Acting Director and General Counsel  
Gloria Long, Co-Acting Director and Deputy Director for Insurance Programs & Services  
Jason A. Hought, CPA, Co-Acting Director and Chief Financial Officer



Certificate of  
Achievement  
for Excellence  
in Financial  
Reporting

Presented to  
West Virginia Public Employees  
Insurance Agency

For its Comprehensive Annual  
Financial Report  
for the Fiscal Year Ended  
June 30, 2003

A Certificate of Achievement for Excellence in Financial  
Reporting is presented by the Government Finance Officers  
Association of the United States and Canada to  
government units and public employee retirement  
systems whose comprehensive annual financial  
reports (CAFRs) achieve the highest  
standards in government accounting  
and financial reporting.



*Nancy L. Ziehl*

President

*Jeffrey R. Emen*

Executive Director



# Financial Section

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The Face to Face Diabetes Program is a pilot project for PEIA PPB Plan insureds with diabetes who live in selected counties. Participants will be required to select a Program pharmacist who will provide one-on-one diabetes care coordination at scheduled appointments. The Face to Face Diabetes Program was developed to improve the health care status of members with diabetes while reducing their medical costs. PEIA members participating in this program will receive the benefit of waived co-payments for diabetes-related prescription drugs and lab studies.

Face to Face members will be required to attend scheduled visits with the pharmacist and strive to achieve various “goals” they have established in relation to their health care needs and abilities. This disease management program involves: participating pharmacists who have completed a diabetes certification program, the CAMC Health Education and Research Institute and various PEIA staff. The pilot program will be evaluated using clinical outcomes using guidelines identified by the Health Care Authority.

PEIA has received positive feedback from pharmacists and members concerning specific results in clinical outcomes and overall satisfaction with the Program. Members benefit by saving money and improving their understanding of their medical condition while PEIA benefits from the potential savings in lower costs due to fewer complications (hospitalization, lab tests and drugs) needed for treatment.



Ernst & Young LLP  
500 United Center  
500 Virginia Street East (25301)  
P.O. Box 2906  
Charleston, West Virginia 25330

Phone: (304) 343-8971  
Fax: (304) 357-5994  
www.ey.com

### Report of Independent Auditors

Board of Directors  
West Virginia Public Employees Insurance Agency

We have audited the accompanying statements of net assets of the West Virginia Public Employees Insurance Agency (PEIA) as of June 30, 2004 and 2003, and the related statements of revenues, expenses, and changes in net asset and cash flows for the years then ended. These financial statements are the responsibility of PEIA's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether these financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of PEIA at June 30, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 7, 2004, on our consideration of PEIA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management discussion and analysis on pages 14 through 18 and the unaudited supplemental schedule of Ten-Year Claims Development Information on page 35 are not a required part of the basic financial statements, but are supplementary information required by GASB. We have applied certain limited procedures to the management discussion and analysis on pages 14 through 18 and the Ten-Year Claims Development Information on page 35, which consisted principally of inquiries of management regarding the methods of measurement and presentation of supplementary information. However, we did not audit the information and express no opinion on it.

The data included in the introductory and statistical sections of this report have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

October 7, 2004

A Member Practice of Ernst & Young Global

## West Virginia Public Employees Insurance Agency

### Management's Discussion and Analysis

Year ended June 30, 2004

This section of the annual financial report of the West Virginia Public Employees Insurance Agency (the Plan) presents a discussion and analysis of the financial performance of the Plan for the year ended June 30, 2004. Please read it in conjunction with the basic financial statements, which follow this section.

### OVERVIEW OF THE FINANCIAL STATEMENTS

The Plan's basic financial statements are prepared in accordance with accounting principles generally accepted in the United States of America for governmental entities and insurance enterprises where applicable. The primary purpose of the Plan is to provide group health and prescription drug insurance for the employees of state agencies, colleges and universities, county school boards, and other governmental units as set forth in the West Virginia Public Employees Insurance Act of 1971 as amended. The Plan operates in a manner similar to any other insurance company. The Plan is an enterprise fund of the state of West Virginia and is combined with other similar funds to comprise the enterprise funds of the state of West Virginia. The basic financial statements are presented on the accrual basis of accounting. The three basic financial statements presented within the financial statements are as follows:

*Statement of Net Assets*—This statement presents information reflecting the Plan's assets, liabilities, and net assets. Net assets represent the amount of total assets less total liabilities. The statement of net assets is categorized as to current and noncurrent assets and liabilities. For purposes of the basic financial statements, current assets and liabilities are those assets and liabilities with immediate liquidity or which are collectible or become due within 12 months of the statement date.

*Statement of Revenues, Expenses and Changes in Net Assets*—This statement reflects the Plan's operating revenues and expenses, as well as nonoperating revenues during the operating year. The major source of operating revenues is premium income, while major expense areas include medical and prescription drug claims costs. The change in net assets for an enterprise fund is similar to net profit or loss for any other insurance company.

*Statement of Cash Flows*—The statement of cash flows is presented on the direct method of reporting which reflects cash flows from operating, capital, and investing activities. Cash collections and payments are reflected in this statement to arrive at net increase or decrease in cash for the fiscal year.

# West Virginia Public Employees Insurance Agency

## Management's Discussion and Analysis (continued)

### FINANCIAL HIGHLIGHTS

The following tables summarize the financial position and the results of operations as of and for the years ended June 30:

|   | 2004           | 2003           | 2002           | Change 2004 – 2003 |         | Change 2003 - 2002 |          |
|---|----------------|----------------|----------------|--------------------|---------|--------------------|----------|
|   |                |                |                | Amount             | Percent | Amount             | Percent  |
| Cash and cash equivalents                     | \$ 187,668,484 | \$ 119,019,129 | \$ 91,169,031  | \$ 68,649,355      | 57.7%   | \$ 27,850,098      | 30.5%    |
| Premium receivable                            | 15,525,418     | 19,127,688     | 14,634,547     | (3,602,270)        | (18.8%) | 4,493,141          | 30.7%    |
| Other current assets                          | 6,508,802      | 6,559,431      | 4,875,085      | (50,629)           | (0.8%)  | 1,684,346          | 34.6%    |
| Total current assets                          | 209,702,704    | 144,706,248    | 110,678,663    | 64,996,456         | 44.9%   | 34,027,585         | 30.7%    |
| Cash and cash equivalents:                    |                |                |                |                    |         |                    |          |
| Premium stabilization fund                    | 3,942,557      | 1,350,738      | 1,698,206      | 2,591,819          | 191.9%  | (347,468)          | (20.5%)  |
| Furniture and equipment, net                  | 90,070         | 114,789        | 160,731        | (24,719)           | (21.5%) | (45,942)           | (28.6%)  |
| Total assets                                  | 213,735,331    | 146,171,775    | 112,537,600    | 67,563,556         | 46.2%   | 33,634,175         | 29.9%    |
| Claims payable                                | 61,689,785     | 60,954,556     | 62,392,297     | 735,229            | 1.2%    | (1,437,741)        | (2.3%)   |
| Other current liabilities                     | 8,357,775      | 7,695,000      | 6,208,191      | 662,775            | 8.6%    | 1,486,809          | 23.9%    |
| Total current liabilities                     | 70,047,560     | 68,649,556     | 68,600,488     | 1,398,004          | 2.0%    | 49,068             | 0.1%     |
| Noncurrent liabilities:                       |                |                |                |                    |         |                    |          |
| Premium stabilization fund                    | 3,942,557      | 1,350,738      | 1,698,206      | 2,591,819          | 191.9%  | (347,468)          | (20.5%)  |
| Net assets-invested in capital assets         | 90,070         | 114,789        | 160,731        | (24,719)           | (21.5%) | (45,942)           | (28.6%)  |
| Net assets-unrestricted                       | 139,655,144    | 76,056,672     | 42,078,175     | 63,598,472         | 83.6%   | 33,978,497         | 80.8%    |
| Total net assets                              | \$ 139,745,214 | \$ 76,171,461  | \$ 42,238,906  | \$ 63,573,753      | 83.5%   | \$ 33,932,555      | 80.3%    |
| Net premium revenue                           | \$ 506,003,267 | \$ 438,072,864 | \$ 366,701,388 | \$ 67,930,403      | 15.5%   | \$ 71,371,476      | 19.5%    |
| Administrative fees, net                      | 6,035,393      | 4,766,910      | 4,656,388      | 1,268,483          | 26.6%   | 110,522            | 2.4%     |
| Total operating revenue                       | 512,038,660    | 442,839,774    | 371,357,776    | 69,198,886         | 15.6%   | 71,481,998         | 19.2%    |
| Claims expense, net                           | 426,667,298    | 389,312,256    | 379,258,215    | 37,355,042         | 9.6%    | 10,054,041         | 2.7%     |
| Administrative service fees and other expense | 23,346,723     | 21,194,674     | 16,531,616     | 2,152,049          | 10.2%   | 4,663,058          | 28.2%    |
| Total operating expenses                      | 450,014,021    | 410,506,930    | 395,789,831    | 39,507,091         | 9.6%    | 14,717,099         | 3.7%     |
| Operating income (loss)                       | 62,024,639     | 32,332,844     | (24,432,055)   | 29,691,795         | 91.8%   | 56,764,899         | (232.3%) |
| Net investment income                         | 1,549,114      | 1,599,711      | 3,099,867      | (50,597)           | (3.2%)  | (1,500,156)        | (48.4%)  |
| Supplemental appropriations                   | -              | -              | 5,800,000      | -                  | -%      | (5,800,000)        | (100.0%) |
| Income (loss) before transfers                | 63,573,753     | 33,932,555     | (15,532,188)   | 29,641,198         | 87.4%   | 49,464,743         | (318.5%) |
| Change in net assets                          | 63,573,753     | 33,932,555     | (15,532,188)   | 29,641,198         | 87.4%   | 49,464,743         | (318.5%) |
| Net assets, beginning of year                 | 76,171,461     | 42,238,906     | 57,771,094     | 33,932,555         | 80.3%   | (15,532,188)       | (26.9%)  |
| Net assets, end of year                       | \$ 139,745,214 | \$ 76,171,461  | \$ 42,238,906  | \$ 63,573,753      | 83.5%   | \$ 33,932,555      | 80.3%    |



## **West Virginia Public Employees Insurance Agency**

### **Management's Discussion and Analysis (continued)**

Net assets at year ended June 30, 2004 increased approximately \$63.6 million after increasing \$33.9 million in the previous year. These improvements resulted primarily from the increases in operation earnings achieved in each of the two years.

Premium receivable at June 30, 2004 was \$3.6 million less than the prior year due to increased collection efforts. At year end 2003 premium receivable was at \$4.5 million above year end 2002 due to an increase in health insurance premium rates.

Cash and cash equivalents, exclusive of the premium stabilization fund, increased by approximately \$68.6 million during the current year after having increased \$27.9 million in the previous year. These increases are primarily due to increased income.

The premium stabilization fund, which represents cash received from optional life insurance dividends, increased by approximately \$2.6 million in 2004 as a result of positive operating results. In the previous year a reduction of these funds of approximately \$.3 million resulted from the use of these funds to reduce optional life insurance premium rates charged to the policyholders.

Claims payable has remained at a relatively consistent level throughout the three year period. An increase of \$.7 million occurred in the current year while a decrease of \$1.4 million was achieved in the prior year. The current year increase resulted from a somewhat slower claims processing timeframe while the prior year decrease was primarily due to a decrease in hospital reimbursement rates.

Other liabilities have increased approximately \$3.3 million in the current year due to an increase in premium stabilization cash which is due to be paid for the optional life policyholders and an increase in deferred revenues of approximately \$.7 million. The prior year increase of \$1.1 million was due to increases in non-claims related accounts payable and other liabilities.

The \$67.9 million increase in net premium revenue resulted from an increase in health insurance premium rates of an average of 14%, plus an increase in policy count of approximately 1.6% less an increase in payments to managed care of approximately \$5.1 million due to increased per policy capitation rates in year end 2004. In year end 2003 these revenues increased approximately \$71.4 million primarily as the result of increases in health insurance premium rates, overall increase in health insurance enrollment of approximately 1.1% less an increase of approximately \$4.8 million in payments to managed care organizations and life insurance premiums.

## **West Virginia Public Employees Insurance Agency**

### **Management's Discussion and Analysis (continued)**

Medical and prescription drug claims expense represent approximately 95% of total Plan operating expenses over the three year period. In 2004 total claims expense increased \$37.4 million or 9.6% above the prior year. In the current year medical claims increased by \$26.2 million or 9.7% and prescription drug claims increased \$11.2 million or 9.4%. The primary drivers of the current year claims cost increases were higher member counts, increased utilization and new and more expensive medical technology and prescription drugs. In the prior year claims expense increased \$10 million or 2.7%. For the year 2003, the total claims costs were mitigated by State legislation which directed higher reimbursement levels and greater funding for the State's Medicaid program along with a reduction in PEIA reimbursement levels, much larger prescription drug rebates, increased usage of generic drugs and a more tightly controlled utilization program.

Throughout the three year period, administrative service fees and other expenses have represented approximately 5% of total Plan operating expenses. In the current year administrative service fees increased \$.6 million as the result of increased member counts and utilization while other expenses increased \$1.5 million, primarily as a result of increased Plan investment in the wellness program, producing a combined increase of approximately \$2.2 million or 10.2% above the previous year. For Plan year 2003 this cost category increased \$4.7 million or 28% above the previous year with \$3.5 million of the increase arising from a redesign of its prescription benefit management contract through which substantially larger prescription drug rebates were earned in exchange for larger drug administrative service fees. The balance of the 2003 increase arose from increased spending for wellness, increases in staff and higher usage of outside professionals in order to better serve the membership.

As previously mentioned, the Plan experienced an increase of approximately \$64 million, or 83.5% in total net assets for the year ended June 30, 2004, and \$34 million, or 80.3% in the previous year. The premium rates adopted for the current year were based on assumptions used in developing the financial plan for 2004, which reflected an expected increase in total net assets of approximately \$39 million, however; total claims costs for the year ended at \$18 million less than the forecast, while premium revenues and other areas increased approximately \$6 million and \$1 million over forecast, respectively. Plan year 2003 finished with an increase of approximately \$34 million or 80.3% in total net assets which was an improvement of \$26 million over original forecast results. The year 2003 improvement resulted primarily from \$23 million lower than expected claims cost, an improvement of approximately \$2 million in premium revenue and \$1 million in other areas.

**West Virginia Public Employees Insurance Agency**

**Management's Discussion and Analysis (continued)**

**ECONOMIC CONDITIONS**

After allowing for the contribution to retiree healthcare cost which is included in the active policyholder premium amount, the Plan's average active employee family monthly premium cost is \$641.48 compared to the national average cost of \$829.17. It should also be noted that the Plan's monthly premium cost above has not been adjusted to reflect the \$64 million earned during the year that will be used to mitigate future premium increases.

The rate of healthcare premium inflation is directly driven by new and more expensive medical technology including medical equipment and prescription drugs and the reluctance of employers and policyholders to limit their financial exposure. For the annual period which ended in the spring of 2004, health insurance cost rose 11.2% nationally. During the same period the overall inflation rate held to 2.3% and wage gains were limited to 2.2%. Such disparity reduces disposable incomes of policyholders as they are asked to bear a larger share of healthcare cost and stresses the operations of their employers.

Due to surpluses generated during recent years the Plan has limited its premium increase to \$13 million for the year which began July 1, 2004 and is presently forecasted to end fiscal year 2005 with a change in net assets of approximately \$16 million.

**CAPITAL ASSET AND LONG-TERM DEBT ACTIVITY**

The Plan has minimal capital assets that are not fully depreciated and has no long-term debt.

# West Virginia Public Employees Insurance Agency

## Statements of Net Assets

|   | June 30        |                |
|---|----------------|----------------|
|   | 2004           | 2003           |
| <b>Assets</b>   |                |                |
| Current assets:   |                |                |
| Cash and cash equivalents   | \$ 187,668,484 | \$ 119,019,129 |
| Premiums receivable:  |                |                |
| Due from State of West Virginia   | 4,629,288      | 3,705,041      |
| Other, less allowance for doubtful accounts of \$680,000 and \$881,000, respectively              | 10,896,130     | 15,422,647     |
| Accounts receivable:  |                |                |
| Provider refunds, less allowance for doubtful accounts of \$545,000 and \$344,000, respectively   | 249,567        | 449,261        |
| Prescription rebates  | 5,976,811      | 5,377,329      |
| Other   | 282,424        | 732,841        |
| Total current assets  | 209,702,704    | 144,706,248    |
| Noncurrent assets:  |                |                |
| Cash and cash equivalents: premium stabilization fund   | 3,942,557      | 1,350,738      |
| Furniture and equipment, net of accumulated depreciation of \$533,017 and \$486,556, respectively | 90,070         | 114,789        |
| Total assets  | 213,735,331    | 146,171,775    |
| <b>Liabilities</b>  |                |                |
| Current liabilities:  |                |                |
| Claims payable  | 61,689,785     | 60,954,556     |
| Accounts payable  | 4,285,666      | 4,311,063      |
| Deferred revenue  | 2,868,337      | 2,212,693      |
| Other accrued liabilities   | 1,203,772      | 1,171,264      |
| Total current liabilities   | 70,047,560     | 68,649,576     |
| Noncurrent liabilities:   |                |                |
| Other accrued liabilities: Premium stabilization fund   | 3,942,557      | 1,350,738      |
|   | 3,942,557      | 1,350,738      |
| Total liabilities   | 73,990,117     | 70,000,314     |
| <b>Net assets</b>   |                |                |
| Invested in capital assets, net of related debt   | 90,070         | 114,789        |
| Unrestricted  | 139,655,144    | 76,056,672     |
| Total net assets  | \$ 139,745,214 | \$ 76,171,461  |

See accompanying notes.



## West Virginia Public Employees Insurance Agency

### Statements of Revenues, Expenses, and Changes in Net Assets

|  | Years ended June 30 |                |
|--|---------------------|----------------|
|  | 2004                | 2003           |
| Operating revenues:                    |                     |                |
| Premiums                               | \$ 567,836,346      | \$ 494,803,110 |
| Less:                                  |                     |                |
| Payments to managed care organizations | (55,471,086)        | (50,336,032)   |
| Life reinsurance premiums              | (6,361,993)         | (6,394,214)    |
| Net premium revenue                    | 506,003,267         | 438,072,864    |
| Administrative fees, net of refunds    | 6,035,393           | 4,766,910      |
| Total operating revenues               | 512,038,660         | 442,839,774    |
| Operating expenses:                    |                     |                |
| Claims expense, net                    | 426,667,298         | 389,312,256    |
| Administrative service fees            | 15,082,572          | 14,444,565     |
| Other expenses                         | 8,264,151           | 6,750,109      |
| Total operating expenses               | 450,014,021         | 410,506,930    |
| Net operating income                   | 62,024,639          | 32,332,844     |
| Nonoperating revenues:                 |                     |                |
| Investment income, net of fees         | 1,549,114           | 1,599,711      |
| Change in net assets                   | 63,573,753          | 33,932,555     |
| Net assets at beginning of year        | 76,171,461          | 42,238,906     |
| Net assets at end of year              | \$ 139,745,214      | \$ 76,171,461  |

*See accompanying notes.*

## West Virginia Public Employees Insurance Agency

### Statements of Cash Flows

|   | Years ended June 30   |                       |
|---|-----------------------|-----------------------|
|   | 2004                  | 2003                  |
| <b>Cash flows from operating activities</b>                     |                       |                       |
| Cash received from participants                                 | \$ 516,319,881        | \$ 435,981,532        |
| Cash received from pharmacy rebates                             | 15,043,481            | 8,816,011             |
| Cash paid to employees  | (2,093,351)           | (1,842,206)           |
| Cash paid to suppliers and others                               | (18,580,659)          | (17,444,413)          |
| Cash paid for claims  | (440,975,550)         | (399,566,008)         |
| Net cash provided by operating activities                       | 69,713,802            | 25,944,916            |
| <b>Cash flows from capital and related financing activities</b> |                       |                       |
| Cash purchases of furniture and equipment                       | (21,742)              | (41,997)              |
| Net cash used in capital and related financing activities       | (21,742)              | (41,997)              |
| <b>Cash flows from investing activities</b>                     |                       |                       |
| Cash received from investment earnings (net)                    | 1,549,114             | 1,599,711             |
| Net cash provided by investing activities                       | 1,549,114             | 1,599,711             |
| Net increase in cash and cash equivalents                       | 71,241,174            | 27,502,630            |
| Cash and cash equivalents at beginning of year                  | 120,369,867           | 92,867,237            |
| Cash and cash equivalents at end of year                        | <u>\$ 191,611,041</u> | <u>\$ 120,369,867</u> |

# West Virginia Public Employees Insurance Agency

## Statements of Cash Flows (continued)

|  | Years ended June 30 |               |
|--|---------------------|---------------|
|  | 2004                | 2003          |
| <b>Reconciliation of operating income to net cash provided by operating activities</b> |                     |               |
| Operating income   | \$ 62,024,639       | \$ 32,332,844 |
| <b>Adjustments</b>   |                     |               |
| Depreciation   | 46,462              | 87,939        |
| Decrease (increase) in operating assets:   |                     |               |
| Premium receivable   | 4,526,517           | (4,724,544)   |
| Due from State of West Virginia  | (924,247)           | 231,403       |
| Provider refunds receivable  | 199,694             | 624,550       |
| Prescription refunds receivable  | (599,482)           | (2,935,613)   |
| Other  | 450,417             | 626,717       |
| Increase (decrease) in operating liabilities:  |                     |               |
| Claims payable   | 735,229             | (1,437,741)   |
| Accounts payable   | (25,397)            | 1,524,209     |
| Premium deficiency reserve   |                     | -             |
| Deferred revenue   | 655,644             | (370,921)     |
| Other accrued liabilities  | 2,624,326           | (13,927)      |
| Total adjustments  | 7,689,163           | (6,387,928)   |
| Net cash provided by operating activities  | \$ 69,713,802       | \$ 25,944,916 |

*See accompanying notes.*

## West Virginia Public Employees Insurance Agency

### Notes to Financial Statements

Years ended June 30, 2004 and 2003

#### 1. Reporting Entity

The State of West Virginia Public Employees Insurance Agency (PEIA) was established under the Public Employees Insurance Act of 1971 (Act). PEIA is an agency of the State of West Virginia and, accordingly, is reported as an enterprise fund of the primary government in the State's Comprehensive Annual Financial Report (CAFR).

PEIA provides the following basic employee benefit coverage to all participants: hospital, surgical, group major medical, basic group life, accidental death, and prescription drug coverage for active and retired employees of the State of West Virginia (State) and various related State and non-State agencies. Additionally, all participants may elect to purchase additional life insurance under the optional life insurance policy. All premium rates are established based upon projected coverage costs as reviewed and approved by the Finance Board of PEIA. See "Budgetary Requirements" for further discussion of this process. PEIA's enrollment consists of approximately 103,000 health and basic life insurance policyholders, and 14,000 policyholders with life insurance only. PEIA insures approximately 219,000 individuals, including participants and dependents.

The financial statements of the PEIA are intended to present the financial position, and the changes in financial position and cash flows of only that portion of the business-type activities of the State of West Virginia that is attributable to the transactions of the PEIA. They do not purport to, and do not, present fairly the financial position of the State of West Virginia as of June 30, 2004, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

#### 2. Summary of Significant Accounting Policies

##### Basis of Reporting

PEIA operates as an insurance enterprise fund. Accordingly, the financial statements of PEIA have been prepared on the accrual basis in conformity with accounting principles generally accepted in the United States of America for governmental entities as prescribed or permitted by the Governmental Accounting Standards Board (GASB). Revenues mainly are derived from premiums earned net of related reinsurance premiums, plus administrative fees billed. Expenses consist primarily of claims, administrative service fees, and various general and administrative costs. In September 1993, GASB issued Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. As permitted by the Statement, PEIA has elected not to adopt Financial Accounting Standards Board (FASB) statements and interpretations issued after November 30, 1989, unless GASB specifically adopts such FASB statements or interpretations.

## West Virginia Public Employees Insurance Agency

### Notes to Financial Statements (continued)

#### 2. Summary of Significant Accounting Policies (continued)

##### Reclassifications

Certain prior-year amounts have been reclassified to conform with the current year financial statement presentation. Such reclassifications did not impact net assets or the change in net assets.

##### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from management's estimates.

##### Budgetary Requirements

The Act requires the Finance Board of PEIA to prepare a proposed annual financial plan. The plan must be designed to generate sufficient revenues to meet all expected expenses, including insurance, administrative expenses, and incurred but unreported claims of the PEIA. An independent professional actuary must review the plan and give an opinion stating that the plan may be reasonably expected to generate sufficient revenue to meet estimated insurance claims and administrative expenses. The financial plan must be presented to the governor and the legislature no later than January 1, prior to the beginning of the new plan year.

The PEIA Finance Board establishes PEIA premiums based upon its approved annual financial plan. The financial plan projects the anticipated costs of the program for each fiscal year and the premium levels necessary to meet these costs. Any variances between projected and incurred costs are incorporated into subsequent financial plans and subsequent premiums are adjusted accordingly on a prospective basis. Premiums assessed by PEIA are not subject to retroactive adjustment based upon actual costs incurred.

## West Virginia Public Employees Insurance Agency

### Notes to Financial Statements (continued)

#### 2. Summary of Significant Accounting Policies (continued)

##### Cash and Cash Equivalents

Cash and cash equivalents are short-term investments with original maturities of 90 days or less. Cash and cash equivalents principally consist of amounts on deposit in the State Treasurer's Office (STO) that are pooled funds managed by the West Virginia Investment Management Board (IMB). In addition, PEIA makes interest-earning deposits in certain investment pools maintained by IMB that are available to PEIA with overnight notice. Interest income from these investments is prorated to PEIA at rates specified by IMB based on the balance of PEIA's deposits maintained in relation to the total deposits of all state agencies participating in the pool. Because these assets are held in the IMB investment pools, no other disclosures related to credit or market risk are required. However, market risk exists as the value of the investment pools underlying investment assets may decline because of an increase in interest rates or a decline in stock prices. The carrying value of the deposits reflected in the financial statements approximates fair value and approximates the value of the shares in the external investment pool.

The STO has statutory responsibility for the daily cash management activities of the State's agencies, departments, boards, and commissions. The STO determines which funds to transfer to the IMB for investment in accordance with the West Virginia Code, policies set by the IMB, and provisions of bond indentures and trust agreements when applicable. The IMB is governed by a 13-member Board of Trustees. The Governor, the State Auditor and the State Treasurer are members of the Board and the other members are appointed by the Governor. The Board was formed in 1997 to serve as the Trustee to hold certain public pension funds and insurance funds, as well as to provide prudent fiscal administration, investment, and management of the Consolidated Pension Fund and the State's operating funds. The IMB prepares separately issued financial statements covering the pooled funds, which can be obtained from the West Virginia Investment Management Board, 500 Virginia Street East, Suite 200, Charleston, West Virginia 25301.

##### Premiums Receivable

All premiums receivable are reported at their gross premium value due from employers and individual subscribers. The gross value is then reduced by the estimated portion that is expected to be uncollectible based upon management's review of the payment status of the underlying accounts and other economic factors that are deemed necessary in the circumstances.

## West Virginia Public Employees Insurance Agency

### Notes to Financial Statements (continued)

#### 2. Summary of Significant Accounting Policies (continued)

##### Accounts Receivable

Accounts receivable include overpayments made by third-party administrators which are due to PEIA and estimated prescription refunds and rebates which are due PEIA from third-party administrators and other drug companies. The estimated prescription refunds/rebate receivable estimate is based upon estimated prescription claim count and historical average rebate per claim. These receivables have been reduced by the estimated portion that is expected to be uncollectible based upon management's review of the payment status of the underlying accounts and other economic factors that are deemed necessary in the circumstances.

##### Furniture and Equipment

Furniture and equipment with an initial cost of \$1,000 or greater are recorded at cost. PEIA has assigned a useful life of three to five years for the furniture and equipment. Depreciation expense is computed using the straight-line method.

##### Claims Payable and Expense

The liability for unpaid claims and claims processing costs is based on an actuarial estimate of the ultimate cost of settling such claims incurred as of the balance sheet date (including claims reported and in process of settlement, claims reported but not yet processed for settlement, and claims incurred but not yet reported or processed for settlement). The estimated actuarial liability reflects certain assumptions, which include such factors as enrollment, utilization, inflation, and other societal and economic factors. Adjustments to the estimated actuarial liability for the final settlement of claims will be reflected in the year that the actual results of the settlement of the claims are made and are known. The estimated liability is adjusted annually based on the most current claim incurrence and claim settlement history (see Note 6). Claims relating to participants in Managed Care Organizations (MCOs) as well as claims relating to participants covered under the optional life insurance plan are not considered in the liability as PEIA has no liability for the participants who elect such coverage. Additionally, the estimated liability for unpaid claims and claims processing costs is recorded net of amounts ceded to reinsurers for basic life benefits as management believes these reinsured risks are fully recoverable. However, in the event a reinsurer is unable financially to satisfy an obligation, PEIA is responsible for such liability. Claims expense is reported net of pharmacy rebate income of \$15,642,963 and \$12,029,814 for the years ended June 30, 2004 and 2003, respectively.

## West Virginia Public Employees Insurance Agency

### Notes to Financial Statements (continued)

#### 2. Summary of Significant Accounting Policies (continued)

##### Deferred Revenue

Deferred revenue included premium revenues collected for future contract periods and unexpended grant proceeds. These revenues will be recognized in the operating periods in which they are earned or related eligible grant expenditures are incurred.

##### Insurance Programs and Related Premium Revenues

PEIA offers the following types of coverage to its participants: health coverage through a self-insured preferred provider benefit (PPB) plan, health coverage through external MCOs, and life and accidental death and dismemberment (AD&D) insurance benefits under basic and optional plans. PEIA collects premiums for participants in the PPB plan and uses these premiums in the administration of the plan. Additionally, PEIA has the statutory authority to raise additional revenues in the form of premiums without the need for external (legislative) action.

For participants who elect coverage through MCOs, PEIA collects premiums from employers and remits a capitation fee to an MCO carrier. The capitation fees paid by PEIA to each MCO are in accordance with their respective contracts. Benefits are the responsibility of each MCO carrier. The premiums earned by PEIA have been included in gross premium revenue while the capitation fees submitted to each MCO carrier are reflected as payments to MCOs on the financial statements.

Employees covered through PEIA are eligible to obtain life insurance coverage under basic and optional life insurance plans. Basic life benefits and AD&D benefits of \$10,000 are provided to active State employees under the age of 65 at no cost to the employee. Coverage amounts decrease with age. No AD&D benefits are available to retirees. Basic life benefits are available to retirees with coverage ranging from \$2,500 to \$5,000 depending on age. For these basic life benefits, PEIA collects premiums and submits them to the insurance carrier. PEIA has reinsured 100% of these basic benefits; however, PEIA remains contingently liable in the event the insurer does not honor its obligation. The premiums earned for basic life insurance are reflected in gross premiums and the related amounts ceded to the reinsurer are reflected as life reinsurance premiums on the financial statements.



## **West Virginia Public Employees Insurance Agency**

### **Notes to Financial Statements (continued)**

#### **2. Summary of Significant Accounting Policies (continued)**

Active employees may elect to obtain additional optional coverage for both life and AD&D with coverage from \$5,000 to \$500,000 that decreases with age. Active employees may also elect dependent optional life coverage and AD&D at a level up to \$20,000 per spouse and \$10,000 per child. Retirees may obtain optional life insurance coverage from \$5,000 to \$150,000 depending on age; however, optional AD&D insurance is not available to retirees. Retirees may also elect dependent optional life coverage at levels up to \$20,000 for spouse and \$10,000 per child. Amounts collected by PEIA from employees for optional coverage totaled \$19,854,948 and \$16,083,798 during the fiscal years ended June 30, 2004 and 2003, respectively, and were remitted directly to the carrier. In this instance, PEIA functions as an agent and, accordingly, neither these premiums nor the related costs are reflected in the financial statements.

Revenues include an administrative fee that PEIA charges to all participating entities in the plan. The fee is based on the participating entities' number of employees enrolled in the plan.

#### **Administrative Service Fees**

PEIA contracts with and pays administrative service fees to two third-party administrators. These services include processing of insurance claims, precertification reviews, utilization reviews, and various other duties. The majority of related fees are assessed each month based upon the number of covered participants or claims processed at predetermined rates without regard to the period in which a claim is incurred, processed or settled.

#### **Supplemental Appropriations**

Supplemental appropriations represent legally authorized appropriations under West Virginia State Code by the West Virginia Legislature. PEIA did not receive any supplemental appropriations in 2004 or 2003.

## West Virginia Public Employees Insurance Agency

### Notes to Financial Statements (continued)

#### 2. Summary of Significant Accounting Policies (continued)

##### Compensated Absences, Including Postretirement Benefits

Employees fully vest in all earned but unused annual leave and PEIA accrues for obligations that may arise in connection with compensated absences for vacation at the current rate of employee pay. In accordance with State personnel policies, employees vest in any remaining unused sick leave only upon retirement, at which time any unused compensated absence time can be converted into employer paid premiums for postretirement health care coverage through PEIA, or be converted into a greater retirement benefit under the State's Public Employees' Retirement System. The estimated obligation for such benefits, as they relate only to those persons employed directly by PEIA presently or in the past, is recorded as a liability in the accompanying financial statements.

##### Operating Revenues and Expenses

Balances classified as operating revenues and expenses are those that comprise PEIA's ongoing operations. Principal operating revenues include health insurance premiums, life insurance premiums and insurance administration fees, less amounts paid to managed care organizations and life insurance reinsurers. Operating expenses include the cost of medical claims, drug claims, claims adjudication, administration and depreciation of capital assets. Other revenues and expenses are classified as nonoperating in the financial statements.

##### Net Assets

As required by GASB 34, PEIA displays net assets in three components, if applicable: invested in capital assets, net of related debt; restricted, and unrestricted.

*Invested in Capital Assets, Net of Related Debt*—This component of net assets consists of capital assets, including restricted capital assets (if any), net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

*Restricted Net Assets*—Restricted net assets should be reported when constraints placed on the net assets use are either externally imposed (for instance, by creditors, laws, or grantors) or imposed by law through constitutional provisions or enabling legislation. Such constraints limit the PEIA's ability to use the resources to pay current liabilities. When both restricted and unrestricted resources are available for use, it is the PEIA's policy to use restricted resources first, then unrestricted resources as needed.

**West Virginia Public Employees Insurance Agency****Notes to Financial Statements (continued)****2. Summary of Significant Accounting Policies (continued)**

*Unrestricted Net Assets*—Unrestricted net assets consist of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.” In the governmental environment, net assets are often *designated* to indicate that management does not consider them to be available for general operations. These types of constraints on resources are internal and management can remove or modify them. Such internal designations are not reported on the face of the statement of net assets.

West Virginia Code section 5-16-25 requires the Finance Board of PEIA to maintain a reserve of 10% of projected plan costs for general operation purposes and provide future plan stability. In the event the reserve fund exceeds 15% of the actuarial recommended reserve of 20% to 25% of total projected costs, the excess is to be remitted to the Department of Administration. As of June 30, 2004 and 2003, PEIA has sufficient net assets to comply with this code section. Additionally, there were no excess amounts due to the Department of Administration.

**3. Cash and Cash Equivalents**

Following is a summary of PEIA’s cash and cash equivalents as of June 30:

|  | <b>2004</b>                  | <b>2003</b>                  |
|--|------------------------------|------------------------------|
| Cash deposited with IMB (cash liquidity pool): |                              |                              |
| Premium stabilization fund                     | <b>\$ 3,942,557</b>          | \$ 1,350,738                 |
| Other  | <b>176,033,987</b>           | 105,045,697                  |
| Total cash deposited with IMB                  | <b>179,976,544</b>           | 106,396,435                  |
| Cash on deposit with State Treasurers Office   | <b>9,537,430</b>             | 12,460,547                   |
| Deposits with outside financial institutions   | <b>2,097,067</b>             | 1,512,885                    |
|  | <b><u>\$ 191,611,041</u></b> | <b><u>\$ 120,369,867</u></b> |

**4. Custodial Credit Risk Related to Deposits**

Custodial credit risk is the risk that, in the event of a bank failure, the PEIA’s deposits might not be recovered. The PEIA has no deposit policy for custodial credit risk.

As of June 30, 2004, the carrying amount of PEIA’s bank deposits was \$2,097,067 and the respective bank balances totaled \$13,040,504. Of the total bank balance, \$13,035,663 was collateralized with government-sponsored enterprise securities held by financial institutions. These securities are held in the name of the financial institution and not that of PEIA.

## West Virginia Public Employees Insurance Agency

### Notes to Financial Statements (continued)

#### 5. Premium Stabilization Fund

The premium stabilization fund consists of accumulated dividends and interest on participant optional life insurance policies. This account was established in 1979 for the sole purpose of accumulating optional life insurance policy dividends and defraying future premium increases. Because these amounts are designated internally for this purpose, management does not intend on using these resources for operations. For cash flow purposes, cash and cash equivalents include \$3,942,557 and \$1,350,738 as of June 30, 2004 and 2003, respectively, related to this fund.

#### 6. Unpaid Claims Liabilities

As discussed in Note 2, PEIA establishes a liability for both reported and unreported insured events, which includes an estimate of future payments of losses. The following represents changes in those aggregate liabilities, excluding the impact of the change in the premium deficiency reserve, for PEIA for the years ended June 30:

|   | <b>2004</b>           | <b>2003</b>      |
|---|-----------------------|------------------|
|   | <i>(In Thousands)</i> |                  |
| Claims payable, beginning of year                         | \$ 60,955             | \$ 62,392        |
| Inurred claims expenses:                                  |                       |                  |
| Provision for insured events of the current year          | 431,397               | 393,862          |
| (Decrease) in provision for insured events of prior years | (4,730)               | (4,550)          |
| Total incurred claims expense                             | 426,667               | 389,312          |
| Payments:   |                       |                  |
| Claim payments attributable to insured events of:         |                       |                  |
| Current year  | 379,101               | 343,939          |
| Prior years   | 46,831                | 46,810           |
| Total payments  | 425,932               | 390,749          |
| Claims payable, end of year                               | <u>\$ 61,690</u>      | <u>\$ 60,955</u> |

The above payments are net of cash received from pharmacy rebates of \$15,043,481 and \$8,816,011 for the years ended June 30, 2004 and 2003, respectively.

## West Virginia Public Employees Insurance Agency

### Notes to Financial Statements (continued)

#### 7. Employee Benefit Plans

All full-time PEIA employees are eligible to participate in the State of West Virginia Public Employees Retirement System (PERS), a cost-sharing multiple-employer public employee retirement system. Employees who retire at or after age 60 with five or more years of contributory service or who retire at or after age 55 and have completed 25 years of credited service are eligible for retirement benefits as established by State statute. Retirement benefits are payable monthly for life, in the form of a straight-line annuity equal to 2% of the employee's final average salary, multiplied by the number of years of the employee's credited service at the time of retirement. PERS also provides deferred retirement, early retirement, and death and disability benefits and issues an annual report which can be obtained by contacting PERS.

Covered employees are required to contribute 4.5% of their salary to PERS. PEIA is required to contribute 10.5%, effective in year 2004, of covered employees' salaries to PERS. The required employee and employer contribution percentages are determined by actuarial advisement within ranges set by statute. PEIA and employee contributions, both the statutorily required and actual contributions made, for the three years ended June 30 are as follows:

|  | 2004              | 2003              | 2002              |
|--|-------------------|-------------------|-------------------|
| Employer contributions (10.5% in 2004,<br>9.5% in 2003 and 2002) | \$ 221,187        | \$ 192,351        | \$ 137,787        |
| Employee contributions (4.5%)                                    | 93,625            | 91,114            | 65,268            |
| Total contributions  | <u>\$ 314,812</u> | <u>\$ 283,465</u> | <u>\$ 203,055</u> |

#### 8. Postemployment Benefits Other Than Pension Benefits

Upon retirement, an employee may apply unused sick leave or annual leave, or both to reduce their future insurance premiums paid to PEIA or to obtain a greater benefit under PERS. The estimated liability at June 30, 2004 and 2003, for sick leave postretirement benefits approximating \$268,681 and \$270,667, respectively, is included in other accrued liabilities in the statements of net assets. During the years ended June 30, 2004 and 2003, PEIA disbursed \$5,700 and \$5,187, respectively, from the liability balances discussed above to fund health insurance premiums for one of its retirees, who had elected to use their accumulated leave time for health coverage.

## West Virginia Public Employees Insurance Agency

### Notes to Financial Statements (continued)

#### 8. Postemployment Benefits Other Than Pension Benefits (continued)

The GASB has issued Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and No. 45 *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (OPEBs). This OPEB obligation will need to be actuarially determined; an actuarially determined contribution (ARC) in accordance with the GASB requirements will be required, an OPEB obligation and related expense will need to be recorded, and there will be additional disclosures. Management has not completed the complex analysis that will be required to comply with the new standards which will not be effective for the PEIA until 2007. Accordingly, the PEIA cannot reasonably estimate the impact on the financial statements of the new standards.

#### 9. Risk Management

PEIA is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to and illnesses of employees; and natural disasters.

Health insurance coverage for PEIA's employees is available on a contributory basis through PEIA programs. PEIA makes available the following basic employee benefit coverage to all participants: hospital, surgical, group major medical, basic group life, accidental death, and prescription drug coverage for active and retired employees. Additionally, PEIA has obtained coverage for job-related injuries through its participation in the West Virginia Workers' Compensation Fund, a public entity risk pool. Furthermore, PEIA participates in the West Virginia State Board of Risk and Insurance Management, a public entity risk pool, to obtain coverage in the amount of \$1,000,000 per occurrence for general liability and property damage. There have been no settlements that have exceeded this coverage in the last three years.

#### 10. Litigation

PEIA is engaged in various legal actions that it deems to be in the ordinary course of business. PEIA believes that it has adequately provided for probable costs of current litigation. As these legal actions are resolved, however, PEIA could realize positive and/or negative impact to its financial performance in the period in which these legal actions are ultimately decided.

PEIA is the defendant in a dispute with its former prescription benefit manager (PBM), which essentially maintains that PEIA owes it approximately \$3 million based upon a shared savings provision in the contract. PEIA is also the plaintiff in a dispute with its former PBM maintaining the PBM did not live up to their contract and owes PEIA damages in an unspecified amount. The ultimate outcome of this matter cannot be determined at the present time. In the opinion of management, after consultation with legal counsel, resolution of this matter is not expected to have a material adverse effect on net assets.

**Required Supplemental Schedule**

## West Virginia Public Employees Insurance Agency

### Ten-Year Claims Development Information (unaudited)

(In Thousands)

The table below illustrates how PEIA's earned premiums (net of reinsurance) and investment income compare to related costs of loss (net of loss assumed by reinsurers) and other expenses assumed by PEIA as of the end of each of the years presented. The rows of the table are defined as follows: (1) This line shows the total of each fiscal year's earned and ceded premiums, administrative fees, other operating and investment revenues. (2) This line shows each fiscal year's other operating costs of PEIA including overhead and unallocated claims expense not allocable to individual claims. (3) This line shows PEIA's incurred and ceded claims and allocated claims adjustment expense (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage occurred (called accident year). (4) These lines show the cumulative amounts paid as of the end of successive years for each accident year. (5) This line shows the most current estimate of losses assumed by reinsurers for each accident year. (6) These lines show how each accident year's incurred claims increased or decreased as of the end of successive years. This annual re-estimation results from new information received on known claims, re-evaluation of existing information on known claims, as well as emergence of new claims not previously known. (7) This line compares the latest re-estimated incurred claims amount to the amount originally established (line 3) and shows whether this latest estimate of claims cost is greater or less than originally thought. As data for individual accident years mature, the correlation between original estimates and re-estimated amounts is commonly used to evaluate the accuracy of incurred claims currently recognized in less mature accident years. The columns of the table show data for successive accident years.

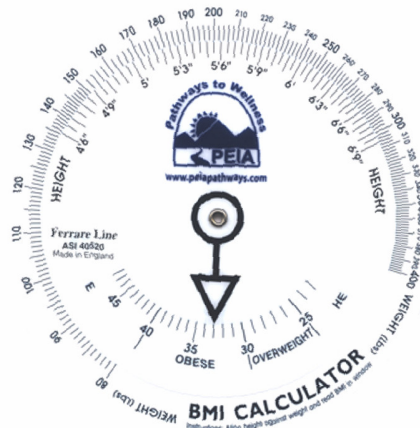
|   | Fiscal and Policy Years ended June 30 |            |            |            |            |            |            |            |            |            |
|---|---------------------------------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
|   | 1995                                  | 1996       | 1997       | 1998       | 1999       | 2000       | 2001       | 2002       | 2003       | 2004       |
| 1) Premiums, investment, and other revenues:  |                                       |            |            |            |            |            |            |            |            |            |
| Earned  | \$ 285,553                            | \$ 295,559 | \$ 312,476 | \$ 329,296 | \$ 373,698 | \$ 388,179 | \$ 417,673 | \$ 432,220 | \$ 501,170 | \$ 575,420 |
| Ceded   | 27,097                                | 67,357     | 90,070     | 85,859     | 74,201     | 75,298     | 76,656     | 51,962     | 56,730     | 61,833     |
| Net earned  | 258,456                               | 228,202    | 222,406    | 243,437    | 299,497    | 312,881    | 341,017    | 380,258    | 444,440    | 513,587    |
| 2) Unallocated expenses   | 15,651                                | 15,647     | 15,349     | 12,117     | 14,376     | 14,564     | 16,754     | 16,531     | 21,195     | 23,347     |
| 3) Estimated incurred claims and allocated claims adjustment expense, end of accident year:                               |                                       |            |            |            |            |            |            |            |            |            |
| Incurred  | 269,942                               | 293,681    | 318,791    | 333,067    | 351,082    | 334,802    | 388,645    | 431,544    | 450,592    | 493,230    |
| Ceded   | 27,097                                | 67,357     | 90,070     | 85,859     | 74,201     | 75,298     | 76,656     | 51,962     | 56,730     | 61,833     |
| Net incurred  | 242,845                               | 226,324    | 228,721    | 247,208    | 276,881    | 259,504    | 311,989    | 379,582    | 393,862    | 431,397    |
| 4) Paid (cumulative) claims and allocated claims adjustment expense as of:  |                                       |            |            |            |            |            |            |            |            |            |
| End of accident year  | 213,161                               | 174,540    | 177,598    | 198,058    | 236,905    | 217,771    | 262,116    | 327,451    | 343,939    | 379,101    |
| One year later  | 241,156                               | 225,963    | 228,783    | 235,214    | 271,547    | 254,001    | 310,090    | 374,269    | 390,420    |            |
| Two years later   | 241,272                               | 229,191    | 230,653    | 235,719    | 272,155    | 254,852    | 310,047    | 374,685    |            |            |
| Three years later   | 241,272                               | 229,052    | 230,283    | 235,341    | 272,355    | 254,887    | 309,981    |            |            |            |
| Four years later  | 241,272                               | 228,912    | 230,283    | 235,341    | 272,355    | 254,887    |            |            |            |            |
| Five years later  | 241,272                               | 228,912    | 230,283    | 235,341    | 272,355    |            |            |            |            |            |
| Six years later   | 241,272                               | 228,912    | 230,283    | 235,341    |            |            |            |            |            |            |
| Seven years later   | 241,272                               | 228,912    | 230,283    |            |            |            |            |            |            |            |
| Eight years later   | 241,272                               | 228,912    |            |            |            |            |            |            |            |            |
| Nine years later  | 241,272                               |            |            |            |            |            |            |            |            |            |
| 5) Re-estimated ceded claims and expenses   | 27,097                                | 67,357     | 90,070     | 85,859     | 74,201     | 75,298     | 76,656     | 51,962     | 56,730     | -          |
| 6) Re-estimated net incurred claims and allocated claims adjustment expense:  |                                       |            |            |            |            |            |            |            |            |            |
| End of accident year  | 242,845                               | 226,324    | 228,721    | 247,208    | 276,881    | 259,504    | 311,989    | 379,582    | 393,862    | 431,397    |
| One year later  | 241,674                               | 227,191    | 230,636    | 235,542    | 272,337    | 256,492    | 319,539    | 375,350    | 389,662    |            |
| Two years later   | 241,674                               | 228,512    | 229,216    | 234,523    | 272,337    | 255,440    | 319,306    | 375,050    |            |            |
| Three years later   | 241,497                               | 231,224    | 229,046    | 234,523    | 272,757    | 255,355    | 319,076    |            |            |            |
| Four years later  | 241,497                               | 231,224    | 229,046    | 234,523    | 272,757    | 255,270    |            |            |            |            |
| Five years later  | 241,497                               | 231,224    | 229,046    | 234,523    | 272,757    |            |            |            |            |            |
| Six years later   | 241,497                               | 231,224    | 229,046    | 234,523    |            |            |            |            |            |            |
| Seven years later   | 241,497                               | 231,224    | 229,046    |            |            |            |            |            |            |            |
| Eight years later   | 241,497                               | 231,224    |            |            |            |            |            |            |            |            |
| Nine years later  | 241,497                               |            |            |            |            |            |            |            |            |            |
| 7) (Decrease) increase in estimated net incurred claims and allocated claims adjustment expense from end of accident year | (1,348)                               | 4,900      | 325        | (12,685)   | (4,124)    | (4,234)    | 7,087      | (4,532)    | (4,200)    | -          |

Note: The above financial data is summarized for individual contract periods. Subsequent premium and related expense adjustments and reserve developments are recorded in the year incurred for fiscal year financial reporting but are included in the applicable contract year for purposes of the above schedule. Accordingly, components of change in net assets as determined on a contract-year basis will differ from that included in PEIA's fiscal year financial statements.



# Statistical Section

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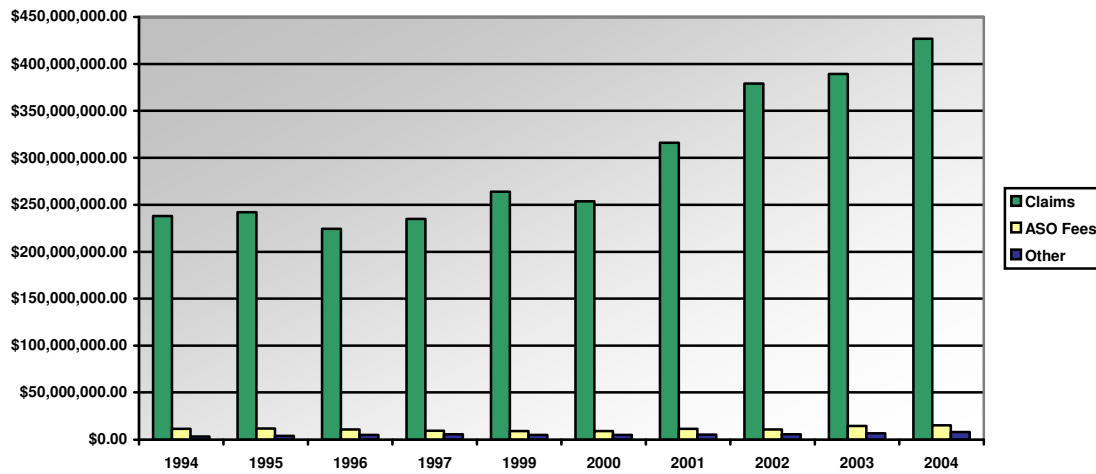
## PEIA Out Front in Addressing Weight Management

West Virginia has the unfortunate distinction of being among the top five most obese states in the nation. Not merely a cosmetic issue, the condition of being overweight is linked to heart disease, diabetes, hypertension and even certain forms of cancer. Over 60% of our members are estimated to be overweight and 30% with a Body Mass Index (BMI) of 30 or greater, meeting the definition of obese. Although PEIA recognizes that there are causal factors which are environmental in nature necessitating broad public policy changes, it is also true that our members are asking for individual support in addressing their weight problems. PEIA is one of the first insurers in the nation to launch a weight management pilot utilizing dietitians, exercise physiologists and in some instances, personal trainers.

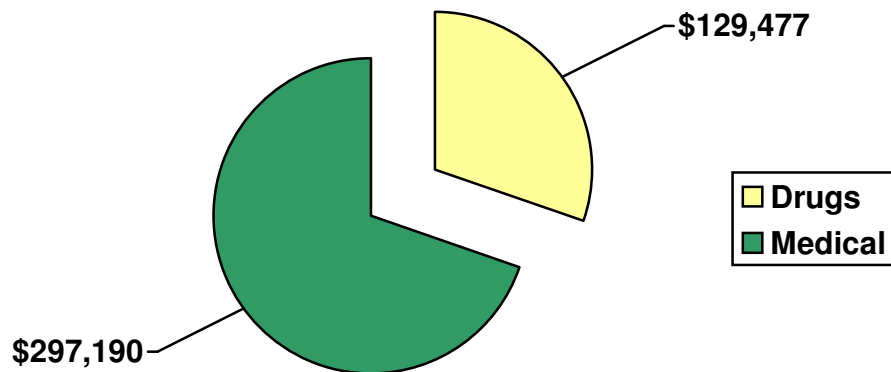
In relation to children, PEIA has partnered with West Virginia University to enroll and track 85 at risk or overweight children in the "Games for Health" project which will utilize an interactive video game called Dance Dance Revolution (DDR). The Games for Health project is built upon the premise that overweight children have negative thoughts about exercise which we expect to improve with DDR participation. With the increase in physical activity we will track any changes in health status which will be assessed through measurements of endothelial function, weight, BMI, lipids, insulin, blood pressure, and aerobic capacity.

Table 1

### Operating Expenses



### Fiscal Year 2004 Claim Expenses (in thousands)



Source: Financial Statements/Internal Claims Data

Table 2

**Comparative Statement of Net Assets** *(Year Ended June 30)*

|  | 2004          | 2003          | 2002          | 2001          |
|--|---------------|---------------|---------------|---------------|
| <b>Assets:</b>   |               |               |               |               |
| <b>Current Assets</b>                                    |               |               |               |               |
| Cash and cash equivalents                                | \$187,668,484 | \$119,019,129 | \$91,169,031  | \$110,799,153 |
| Accounts receivable:                                     |               |               |               |               |
| Due from State of West Virginia                          | 4,629,288     | 3,705,041     | 3,936,444     | 1,331,225     |
| Other, net of allowance for doubtful accounts            | 17,404,932    | 21,982,078    | 15,573,188    | 11,024,741    |
| <i>Total Current Assets</i>                              | \$209,702,704 | \$144,706,248 | \$110,678,663 | \$123,155,119 |
| <b>Noncurrent Assets</b>                                 |               |               |               |               |
| Furniture and equipment, net of accumulated depreciation | 90,070        | 114,789       | 160,731       | 221,531       |
| Restricted cash-premium stabilization                    | 3,942,557     | 1,350,738     | 1,698,206     | 3,607,558     |
| <i>Total Assets</i>                                      | 213,735,331   | 146,171,775   | 112,537,600   | 126,984,208   |
| <b>Liabilities:</b>                                      |               |               |               |               |
| <b>Current Liabilities</b>                               |               |               |               |               |
| Claims payable   | 61,689,785    | 60,954,556    | 62,392,297    | 52,371,174    |
| Premium deficiency reserve                               | -             | -             | -             | 7,242,000     |
| Accounts payable   | 4,285,666     | 4,311,063     | 2,783,945     | 5,278,175     |
| Deferred revenue   | 2,868,337     | 2,212,693     | 2,583,614     | -             |
| Other accrued liabilities                                | 1,203,772     | 1,171,264     | 840,632       | 714,207       |
| <i>Total Current Liabilities</i>                         | 70,047,560    | 68,649,576    | 68,600,488    | 65,605,556    |
| <b>Noncurrent Liabilities</b>                            |               |               |               |               |
| Other accrued liabilities: Premium stabilization fund    | 3,942,557     | 1,350,738     | 1,698,206     | 3,607,558     |
| <b>Net Assets</b>  |               |               |               |               |
| Invested in capital assets, net of related debt          | \$90,070      | \$114,789     | \$160,731     | \$221,531     |
| Unrestricted   | \$139,655,144 | \$76,056,672  | \$42,078,175  | \$57,549,563  |
| <i>Total Net Assets</i>                                  | \$139,745,214 | \$76,171,461  | \$42,238,906  | \$57,771,094  |

Source: Financial Statements

## 2004 Comprehensive Annual Financial Report

| 2000         | 1999         | 1998           | 1997          | 1996         | 1995         |
|--------------|--------------|----------------|---------------|--------------|--------------|
| \$83,168,671 | \$33,826,295 | \$33,616,551   | \$44,043,709  | \$64,760,765 | \$50,965,053 |
| 1,665,317    | 6,375,786    | 5,909,807      | 10,986,255    | 7,165,849    | -            |
| 7,896,748    | 7,069,711    | 6,713,069      | 13,457,896    | 8,999,706    | 15,952,010   |
| \$92,730,736 | \$47,271,792 | \$46,239,427   | \$68,487,860  | \$80,926,320 | \$66,917,063 |
| 281,346      | 295,313      | 208,452        | 72,283        | 63,882       | 80,999       |
| 2,025,790    | -            | 976,343        | 924,669       | 875,785      | 828,019      |
| 95,037,872   | 47,567,105   | 47,424,222     | 69,484,812    | 81,865,987   | 67,826,081   |
| 41,966,795   | 40,605,000   | 49,890,000     | 52,703,000    | 52,934,000   | 31,411,000   |
| -            | -            | 2,560,000      | 13,900,000    | -            | -            |
| 731,744      | 878,539      | 9,791,560      | 11,640,746    | 2,221,767    | 1,578,210    |
| -            | -            | -              | -             | -            | -            |
| 585,122      | 901,001      | 196,395        | 127,579       | 115,054      | 499,054      |
| 43,283,661   | 42,384,540   | 62,437,955     | 78,371,325    | 55,270,821   | 33,488,264   |
| 2,025,790    | -            | 976,343        | 924,669       | 875,785      | 828,019      |
| \$281,346    | \$295,313    | \$208,452      | \$72,283      | \$63,882     | \$80,999     |
| \$49,447,075 | \$4,887,252  | \$(16,198,528) | \$(9,883,465) | \$25,655,499 | \$33,428,799 |
| \$49,728,421 | \$5,182,565  | \$(15,990,076) | \$(9,811,182) | \$25,719,381 | \$33,509,798 |

Table 3

# Comparative Statements of Revenues, Expenses and Changes in Net Assets (Year Ended June 30)

|  | 2004          | 2003          | 2002          | 2001          |
|--|---------------|---------------|---------------|---------------|
| <b>Operating Revenues:</b>             |               |               |               |               |
| Premiums                               | \$567,836,346 | \$494,803,110 | \$418,663,654 | \$396,494,659 |
| Less:                                  |               |               |               |               |
| Payments to managed care organizations | (55,471,086)  | (50,336,032)  | (46,818,034)  | (71,609,138)  |
| Life reinsurance premiums              | (6,361,993)   | (6,394,214)   | (5,144,232)   | (5,047,339)   |
| Net premium revenue                    | 506,003,267   | 438,072,864   | 366,701,388   | 319,838,182   |
| Administrative fees, net of refunds    | 6,035,393     | 4,766,910     | 4,656,388     | 4,612,838     |
| <i>Net operating revenues</i>          | 512,038,660   | 442,839,774   | 371,357,776   | 324,451,020   |
| <b>Operating Expenses:</b>             |               |               |               |               |
| Claims expense                         | 426,667,298   | 389,312,256   | 379,258,215   | 316,219,643   |
| Administrative service fees            | 15,082,572    | 14,444,565    | 10,917,542    | 11,471,003    |
| Other operating expenses               | 8,264,151     | 6,750,109     | 5,614,074     | 5,283,378     |
| <i>Total operating expenses</i>        | 450,014,021   | 410,506,930   | 395,789,831   | 332,974,024   |
| Operating Income (loss)                | 62,024,639    | 32,332,844    | (24,432,055)  | (8,523,004)   |
| <b>Nonoperating Revenues:</b>          |               |               |               |               |
| Investment income, net of fees         | 1,549,114     | 1,599,711     | 3,099,867     | 6,565,677     |
| Supplemental Appropriations            | -             | -             | 5,800,000     | 10,000,000    |
| Other revenue                          | -             | -             | -             | -             |
| <b>Change in Net Assets</b>            | 63,573,753    | 33,932,555    | (15,532,188)  | 8,042,673     |
| Net Assets, Beginning of Year          | 76,171,461    | 42,238,906    | 57,771,094    | 49,728,421    |
| Net Assets, End of Year                | \$139,745,214 | \$76,171,461  | \$42,238,906  | \$57,771,094  |

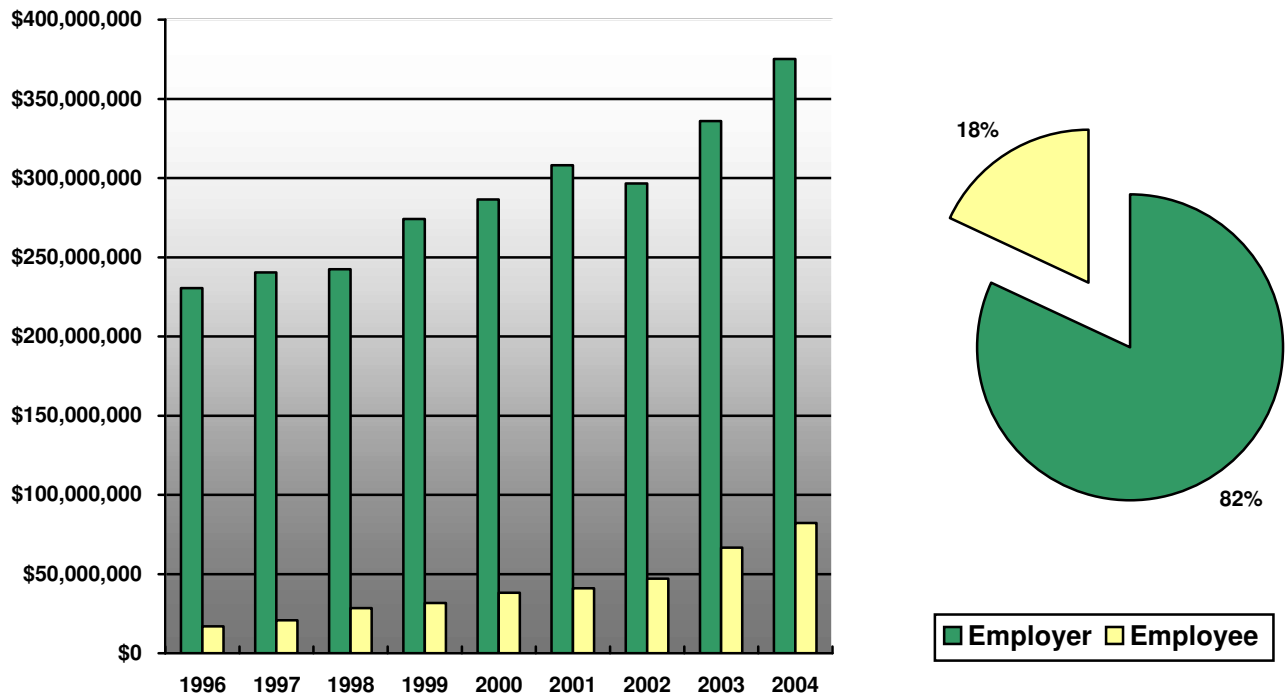
Source: Financial Statements

## 2004 Comprehensive Annual Financial Report

| 2000          | 1999          | 1998           | 1997          | 1996          | 1995          |
|---------------|---------------|----------------|---------------|---------------|---------------|
| \$380,081,007 | \$365,771,569 | \$321,955,257  | \$309,463,427 | \$293,022,029 | \$283,193,465 |
| (70,757,209)  | (69,713,292)  | (81,392,367)   | (85,331,092)  | (62,874,260)  | (18,865,122)  |
| (4,540,875)   | (4,488,068)   | (4,467,264)    | (4,738,484)   | (4,482,996)   | (12,354,667)  |
| 304,782,923   | 291,570,209   | 236,095,626    | 219,393,851   | 225,664,773   | 251,973,676   |
| 3,952,384     | 3,101,354     | 3,025,674      | 2,443,298     | 2,142,011     | 2,004,976     |
| 308,735,307   | 294,671,563   | 239,121,300    | 221,837,149   | 227,806,784   | 253,978,652   |
| 253,771,160   | 263,947,359   | 238,423,500    | 234,821,774   | 224,420,109   | 241,840,981   |
| 9,316,764     | 9,186,157     | 8,229,978      | 9,502,029     | 10,728,050    | 11,746,038    |
| 5,247,246     | 5,190,317     | 3,887,511      | 5,846,761     | 4,919,411     | 3,904,858     |
| 268,335,170   | 278,323,833   | 250,540,989    | 250,170,564   | 240,067,570   | 257,491,877   |
| 40,400,137    | 16,347,730    | (11,419,689)   | (28,333,415)  | (12,260,786)  | (3,513,225)   |
| 3,145,719     | 1,274,911     | 766,126        | 569,736       | 395,135       | 354,780       |
| 1,000,000     | 3,550,000     | 3,550,000      | -             | -             | -             |
| -             | -             | -              | 300,000       | -             | 1,464,321     |
| 44,545,856    | 21,172,641    | (7,103,563)    | (27,463,679)  | (11,865,651)  | (1,694,124)   |
| 5,182,565     | (15,990,076)  | (8,886,513)    | 18,577,166    | 38,460,817    | 36,031,941    |
| \$49,728,421  | \$5,182,565   | (\$15,990,076) | (\$8,886,513) | \$26,595,166  | \$34,337,817  |

*Note: Prior period adjustments were made in fiscal years 1996 and 1997 due to the correction of an error and implementation of GASB 30. As a result, retained earnings balances do not carry forward in the above table for those years.*

Table 4  
**Source of Premium Revenues**  
(State Fund Only)



*Source: Actuarial Financial Reports*



Table 5  
**Enrollment**

The following tables depict PEIA's enrollment for the past seven years. These tables illustrate the growth of the retiree population and the total population, as well as the peak of managed care enrollment in 1997 and the subsequent decline excepting 2003 and 2004.

|                         | 2004    | 2003    | 2002    | 2001   | 2000   | 1999   | 1998   | 1997   | 1996   |
|-------------------------|---------|---------|---------|--------|--------|--------|--------|--------|--------|
| Active Lives            | 72,811  | 72,120  | 71,419  | 70,751 | 70,533 | 70,483 | 71,019 | 71,705 | 71,165 |
| Retirees                | 30,539  | 29,349  | 28,920  | 28,480 | 27,789 | 27,035 | 26,004 | 25,128 | 24,907 |
| <i>Total Enrollment</i> | 103,350 | 101,469 | 100,339 | 99,231 | 98,322 | 97,518 | 97,023 | 96,833 | 96,072 |

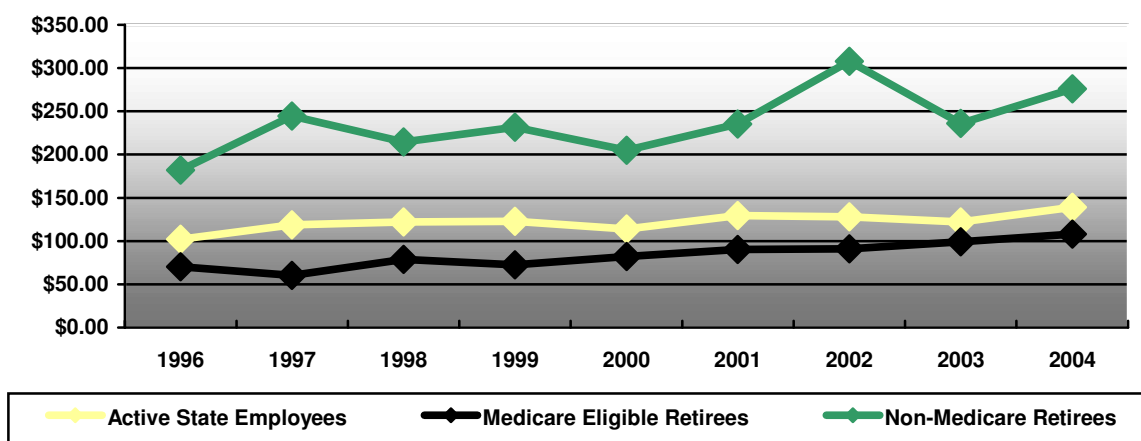
|                         | 2004    | 2003    | 2002    | 2001   | 2000   | 1999   | 1998   | 1997   | 1996   |
|-------------------------|---------|---------|---------|--------|--------|--------|--------|--------|--------|
| PPB Enrollment          | 90,872  | 90,056  | 90,083  | 82,664 | 80,436 | 79,245 | 74,216 | 73,009 | 77,470 |
| MCO Enrollment          | 12,478  | 11,413  | 10,256  | 16,567 | 17,886 | 18,273 | 22,807 | 23,824 | 18,602 |
| <i>Total Enrollment</i> | 103,350 | 101,469 | 100,339 | 99,231 | 98,322 | 97,518 | 97,023 | 96,833 | 96,072 |

Source: Information compiled from the Public Employees Insurance Agency's internal data.

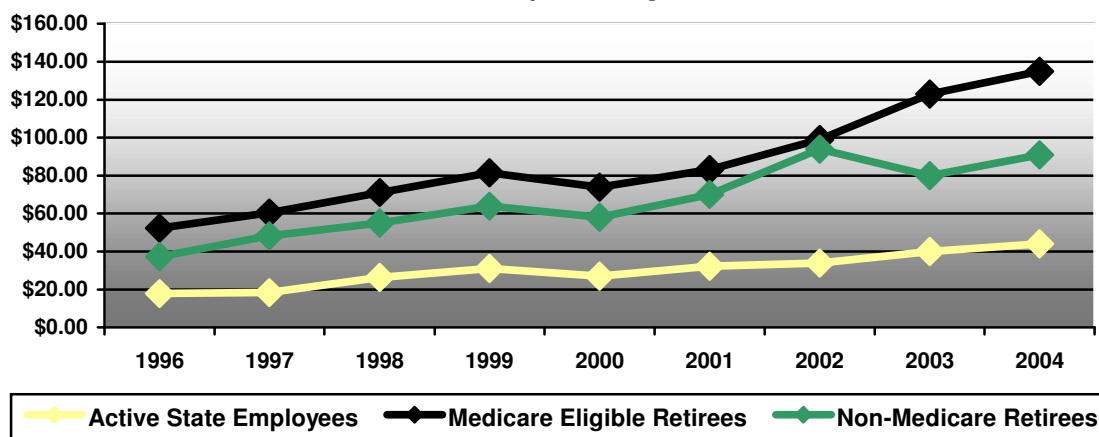
Table 6

# Average Cost Per Member Per Month

## Medical



## Prescription Drugs



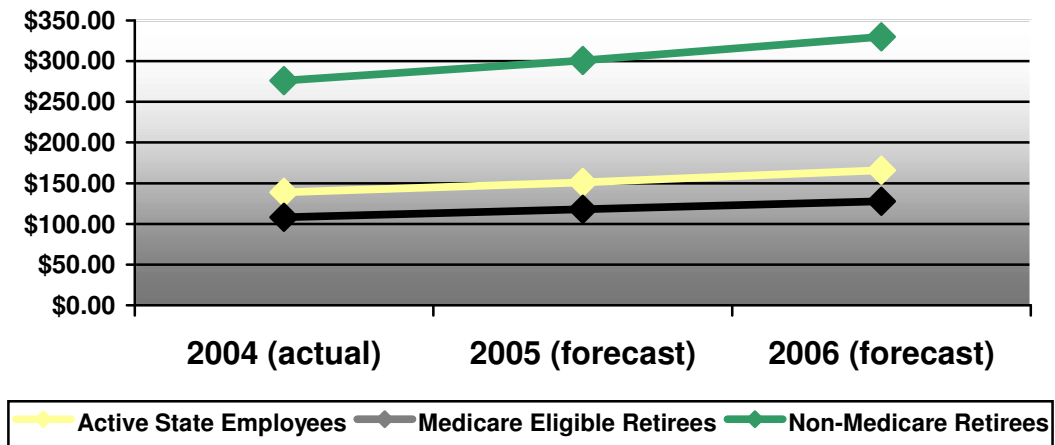
Source: Actuarial Financial Reports

Table 7

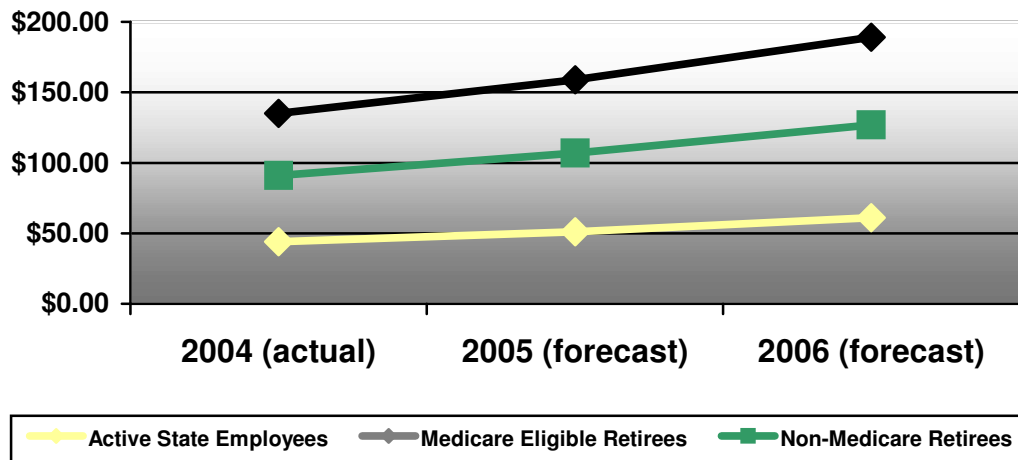
**Trends**

*(Average Cost Per Member Per Month)*

**Medical**



**Prescription Drugs**



Source: Actuarial Financial and Trend Reports

Table 8

**Top 10 Prescription Drugs**

| <b>National</b> |                            |
|-----------------|----------------------------|
|                 | <b>Sales (\$ Billions)</b> |
| LIPITOR         | 7.4                        |
| ZOCOR           | 4.6                        |
| PREVACID        | 3.8                        |
| NEXIUM          | 3.6                        |
| PROCRIT         | 3.2                        |
| ZOLOFT          | 3.1                        |
| EPOGEN          | 3.1                        |
| ZYPREXA         | 2.9                        |
| PLAVIX          | 2.8                        |
| ADVAIR DISKUS   | 2.8                        |

*Source: IMS Health NPA+*

| <b>PEIA</b> |   |                              |
|-------------|---|------------------------------|
|             | <b>PEIA's Annual Cost (\$ Millions)</b> | <b>% of Total Drug Spend</b> |
| Lipitor     | 12.10                                   | 9.38%                        |
| Prevacid    | 5.57                                    | 4.32%                        |
| Plavix      | 3.63                                    | 2.81%                        |
| Omeprazole  | 3.34                                    | 2.59%                        |
| Nexium      | 3.33                                    | 2.58%                        |
| Zoloft      | 3.02                                    | 2.34%                        |
| Actos       | 2.96                                    | 2.29%                        |
| Neurontin   | 2.96                                    | 2.29%                        |
| Celebrex    | 2.94                                    | 2.28%                        |
| Pravachol   | 2.90                                    | 2.25%                        |

*Source: PEIA Claims Detail*

Table 9

### Top 10 Diagnostic Categories by Claims Paid

| Diagnostic Category                            | Paid Claims<br>(in thousands) | # Claims | % Paid |
|--|-------------------------------|----------|--------|
| Diseases of Circulatory System                 | \$37,029                      | 235,821  | 12.89% |
| Neoplasms                                      | \$31,811                      | 111,083  | 11.07  |
| Systems signs and ill defined conditions       | \$31,628                      | 304,469  | 11.01  |
| Musculoskeletal & connective tissue disease    | \$29,133                      | 261,839  | 10.14  |
| Supplemental factors influencing health status | \$24,751                      | 250,308  | 8.61   |
| Diseases of genitourinary system               | \$21,224                      | 139,240  | 7.39   |
| Injury and poisoning                           | \$20,829                      | 135,847  | 7.25   |
| Diseases of digestive system                   | \$20,815                      | 85,520   | 7.24   |
| Diseases of respiratory system                 | \$18,255                      | 247,814  | 6.35   |
| Diseases of nervous system & sense organs      | \$13,377                      | 136,916  | 4.66   |

*Source: PEIA Monthly Healthcare Management Reports*

Table 10  
**Top 25 Participating Agencies**  
*(as of June 30, 2004)*

|  |
|--|
|  |
| West Virginia University                 |
| Department of Transportation             |
| Kanawha County Board of Education        |
| Department of Health and Human Resources |
| Teachers' Retirement Board               |
| Public Employees Retirement Board        |
| Berkeley County Board of Education       |
| Wood County Board of Education           |
| Department of Corrections                |
| Raleigh County Board of Education        |
| Cabell County Board of Education         |
| Marshall University                      |
| Harrison County Board of Education       |
| Monongalia County Board of Education     |
| Mercer County Board of Education         |
| Marion County Board of Education         |
| Supreme Court/Judicial                   |
| Putnam County Board of Education         |
| Public Safety                            |
| Wayne County Board of Education          |
| Fayette County Board of Education        |
| Division of Natural Resources            |
| Division of Environmental Protection     |
| Jefferson County Board of Education      |
| Logan County Board of Education          |
|  |

*Source: Records of PEIA Premium Accounts*